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Gray Drug Stores, Inc.

Annual Report 1972

Stores and Leased Departments

Fiscal Years Ended	April 30	June 30			
	1972	1971	1970	1969	1968
Gray Drug Stores	153	153	119	115	113
King Discount Drug Stores	12	14	15	14	22
Leased Departments in Stores of Other Retailers	30	28	26	24	21
Department Stores	30	27	23	22	22
Total Outlets Excluding Intra-Company Leased Departments	225	222	183	175	178
Leased Departments Operated by Our Own Divisions in Stores of Other Divisions	45	43	31	28	25
Stores Remodeled and Enlarged	17	15	23	26	28

Operations

Fiscal Years Ended April 30	1972	1971
Net Sales	$203,671,431	$167,218,553
Income Before Income Taxes	$ 7,463,249	$ 7,583,559
Net Income	$ 3,906,249	$ 3,814,559
Net Income Per Share	$ 2.35	$ 2.29
Dividends Per Share	$ 1.20	$ 1.20
Working Capital	$ 33,241,218	$ 21,398,868
Current Ratio	1.9 to 1	1.6 to 1
Shareholders' Equity	$ 32,714,560	$ 30,780,690

Gray Drug Stores, Inc., earned $3,906,249 or $2.35 a share during the fiscal year ended April 30, 1972, compared with $3,814,559 or $2.29 a share for the preceding 12 months.

Sales reached a new high for the 23rd consecutive year. The total of $203,671,431 was 21.8 per cent higher than the $167,218,553 of the preceding year.

In line with shareholders' approval at last year's annual meeting, the Company has changed its fiscal year-end to April 30 so that taking of inventories can be carried out more conveniently and economically during the business lull following the Christmas season. The figures reported for the 12-month periods ended April 30, 1972 and 1971 include all adjustments required to make them comparable plus adjustments retroactively required in the 1971 figures as a result of the new Ohio corporate income tax law.

Substantial Growth

On a five-year basis, our sales have increased 118 per cent, from $93,598,000 in 1967 to the $203,671,000 of the past year, and the fact that the increase during fiscal 1972 alone was $36,452,000 or 33 per cent of the five year total indicates the scope of our recent growth.

The first six months of the 1972 fiscal year, as restated, include start-up and promotion costs for 27 drug stores acquired in Florida and three discount department stores acquired in Columbus, plus expenses involved in starting a new distribution center in Cleveland and expansion of the Cincinnati distribution center.

These expenses depressed income during the first half of the fiscal year and had less of an effect on income during the latter half when both the Florida and Columbus stores gradually attained favorable sales levels as a result of their intensive promotion programs, and the Cleveland and Cincinnati distribution centers began making the contributions to efficiency anticipated for them.

A review of quarterly results for the past two years, as restated for comparative purposes on the basis of the April 30 year-end, is interesting in showing income trends during fiscal 1972.

	Earnings Per Share	
Quarter Ended:	Fiscal 1972	Fiscal 1971
July 31	$.52	$.50
Oct. 31	.20	.34
Jan. 31	1.20	1.07
April 30	.43	.38

As these figures indicate, the year ended on an upswing.

270 Retail Outlets

The Company at the fiscal year-end was operating 165 drug stores, 59 leased drug departments in its own department stores and the stores of other retailers, 30 discount department stores, and 16 leased apparel departments of our Rink's department stores division in stores of our Bargain City department stores division . . . a total of 270 retail outlets.

The Drug Division accounted for $114,154,745 or 56 per cent of our sales total and the department store divisions accounted for $89,516,686 or 44 per cent of sales.

During the past two years, the Drug Division has opened or acquired 40 outlets and closed 9 marginal units, for a net gain of 31 outlets . . . or 23 per cent more than in 1970. The department store divisions have acquired or opened seven large stores during the past two years . . . an increase of 32 per cent.

Equally important, we have opened two new distribution centers during the past two years, acquired another, and expanded a fourth . . . providing modern new warehousing facilities totaling 611,000 square feet. These are vital to future expansion and to operating efficiency.

Expansion Planning

Our Company has traditionally been a regional chain with a policy of developing a high degree of saturation in a basic geographic area in which we can maintain close controls on pricing, purchasing and management, build an advertising umbrella, and maintain close relations with shopping center

Jerome A. Weinberger, President and Chief Executive

developers. We believe that such geographic concentration combined with automated warehousing and computerized inventory control has resulted in distribution efficiencies and given us competitive strength.

In both Florida and Columbus, Ohio, our success during the past year in increasing sales of stores acquired from other companies is evidence of this competitive ability. While these acquired units did not make a contribution to profits during their first full year, they will do so if present sales levels continue, and this would represent an important step forward in our operations. A department store acquired during 1972 at Ann Arbor, Michigan, has nearly doubled the rate of sales attained by a previous operator, and its profits have been good.

As a result of our initial experience in Florida, we now have scheduled 11 more drug stores there and intend to continue opening other new Florida stores . . . providing an important new area of expansion in line with our formula of developing regional strength.

The pace of new drug division openings, slowed during the past year by delays in shopping center construction, is picking up sharply and including the Florida openings, 23 new drug division outlets are scheduled, including 20 new drug stores and three leased drug departments.

Our department store divisions have scheduled four new outlets during the current fiscal year. One of these has just been opened in Columbus and we will open a fifth store there. Another new store will be opened at Sidney, Ohio, and a new store will be built at Fairfield, Ohio, to replace a small existing unit nearby. Other new locations are under negotiation.

Current Operations

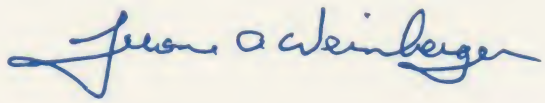
The sales figures of the past year speak for themselves in indicating our renewed growth momentum.

While the expenses required to attain this momentum have been high, we are gratified by the 12 per cent profit increase of the past year's second half, indicating that our organization has been able to translate expansion into income performance.

All divisions report that sales for the first two months of the current fiscal year are above the same months a year ago.

Our expansion and profit improvement programs are working well and our Company has a good opportunity for continuing progress during the 1973 fiscal year now under way.

Sincerely,



Jerome A. Weinberger,
President and Chief Executive

August 4, 1972

Each of our major marketing divisions . . . the Drug Division, Rink's Department Stores, and Bargain City Department Stores . . . increased volume during the past fiscal year and has substantial growth programs under way.

Florida Expansion

The $100,000,000-mark in sales is a significant indication of size, and the Drug Division, assisted by the acquisition of Florida stores, exceeded this level in its 224 outlets during the past fiscal year. Total volume of $114,154,745, compared with $96,938,111 for the preceding 12 months.

Our drug store business has largely been in Ohio and adjacent states. The acquisition as of April 30, 1971, of 27 drug stores in southeast Florida, together with four stores we had previously opened there, provides a base for development of drug store operations on a large-scale basis in a promising new geographic area for us.

We are enthusiastic about the results to date. Five months were spent in redesigning layouts of the acquired stores, remerchandising them, introducing our pricing systems, and identifying the stores with the Gray name. Three of the stores that did not meet our standards were closed or sold. By October, we were ready to launch an intensive "Welcome to Gray's" advertising campaign, which has been continued on a consistent basis.

Sales at the acquired stores have increased steadily under the Gray management team established in Florida. While the start-up and promotion expenses resulted in an initial loss for these stores during their first months as a part of Gray, they reached a profitable level of operation by the end of December and have continued to do well . . . to the extent that we have committed ourselves to making Florida a major area of drug division operations.

An additional store was acquired in Key West, and 11 drug store openings in Florida are on our schedule for the current year . . . including one or more in Fort Myers, Venice, Fort Lauderdale, Lake Worth, Boynton Beach and Hollywood. This expansion takes us to the west coast of Florida for the first time, and additional locations on both coasts are under negotiation.

The Florida drug stores, while utilizing many of our traditional marketing procedures, are at the same time emphasizing features particularly suited to the Florida market . . . including food service, crafts departments for retired people, special items for tourists, and year-around sale of lawn items and furniture. Our Florida operation, within a short time, has become a sound and promising part of our total Drug Division operation.

Drug Division Progress

Sales of Drug Division outlets operated in each of the past two years continued to increase, by a narrow margin early in the year and at a somewhat better rate during recent months.

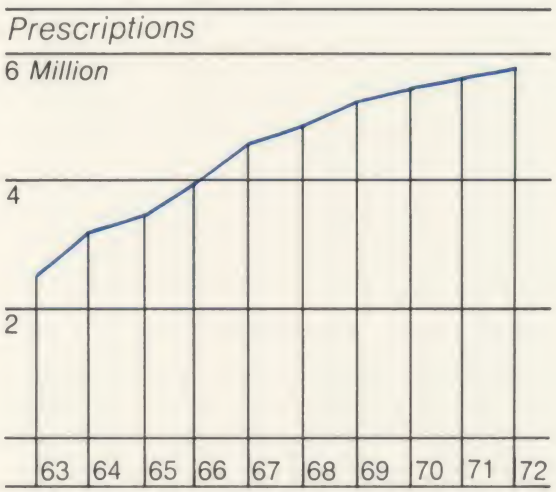
Free-standing drug stores accounted for about 70 per cent of the Drug Division sales in fiscal 1972, and leased departments for about 30 per cent. Our stores are located primarily in faster growing suburban areas, and approximately 95 per cent are in shopping centers.

Our 425 pharmacists filled over 5,800,000 prescriptions during fiscal 1972, for a sales volume of $23,500,000.

Three new stores were completed during the fiscal year . . . at shopping centers in Huron, Toledo, and North Canton, Ohio. Six marginal or losing stores were closed or sold.

Seven leased departments were opened . . . in three Clarkins department stores in the Cleveland area and in a Clarkins store at Elyria, Ohio, and in three of our own department stores. Two leased departments were closed.

The 23 new Drug Division outlets on our schedule include two more stores in Toledo to bring our total to four there, two stores in Columbus, two in Cleveland, two in the Cincinnati area and one in Jamestown, N. Y., in addition to the 11 new Florida stores now planned. All three of the projected new



Fiscal 1972 and 1971 ended April 30; all other years ended June 30.

5,800,000 prescriptions were filled last year at Drug Division's 224 outlets.

leased drug departments will be in our own department stores.

"Discount Pricing" Introduced

The Drug Division recently adopted a policy to extend "discount pricing" to all drug stores, providing a reduction in prescription and health and beauty aids product prices as a means of stimulating sales. The policy was tested in a small but gradually increasing number of stores over a period of more than a year before being generally introduced.

The move to discount pricing is a significant step in our operations, offering consumers the broad product selection and attractive buying environment featured by Gray at prices as low as those normal for so-called discount stores with limited product lines, limited service, and less attractive stores. The discount pricing program, if trends to date continue, could materially benefit the Drug Division. At the same time, our drug stores have adopted a uniform pricing system which could lead to new efficiencies through use of pre-printed price tickets and better measurement of results obtained by individual product lines.

Other Trends

The Drug Division's new 276,000 square foot distribution center opened a year ago involved large start-up costs during the early part of the year but is now operating efficiently . . . enabling us to stock many more items and emphasize the benefits of volume purchases.

Our Superior Laboratories, a part of the Drug Division, operates color and black-and-white film processing plants for our own stores, and also other chains and industrial customers. Its sales continued to increase during the past year.

31 Department Stores

Total sales of the Rink's and Bargain City Stores divisions increased 13 per cent to $147,475,000 during the past fiscal year . . . including $106,358,000 by our own divisions and $41,117,000 in departments leased by other companies. Sales by other companies are not included in our corporate totals but

their rental fees add to our income.

The Drug Division operates leased departments in all but one of our department stores, and Rink's operates 16 women's apparel departments and eight men's and boys' wear departments in Bargain City stores. Of the total $106,358,000 in sales by our own divisions in the department stores, $26,840,000 represented sales by the Drug Division in Rink's and Bargain City stores and by Rink's in Bargain City stores. This indicates the practicality of our intra-Company relationships in which the opening of a new department store also adds volume for one and often two other divisions.

Our department stores are large, up to 100,000 square feet in size, and are generally located in fast-growing suburban areas. In line with our traditional corporate practice, each department store division seeks to build maximum strength within a specific region. All Rink's stores are within 125 miles of its Cincinnati headquarters and all Bargain City stores within 200 miles of its Toledo base.

New Rink's Stores

Rink's operations during the past year featured a large-scale entry into the Columbus, Ohio, market and the opening of a new 100,000 square foot store in Kettering, Ohio.

It acquired three discount department stores in Columbus at the start of the 12-month period beginning May 1, 1971, and acquired a fourth Columbus store in May of the current year. Construction has begun on a fifth Columbus store scheduled for November opening.

Rink's direct sales during the past fiscal year totaled $52,726,000, an increase of 27 per cent, largely resulting from new stores. Intense competition, general consumer buying caution and large start-up and promotion expenses related to the opening of the Columbus and Kettering stores cut into Rink's profits, which were lower than those of the preceding year. Intensive promotion in Columbus has been effective, with sales of the new stores now at favorable levels.

Rink's, whose profit progress has been outstanding in previous years, is now firmly established in the growing Columbus market and has taken many steps to improve sales in other stores.

The Kettering store was designed as an architectural and merchandising prototype for future Rink's stores, and has many innovative features. One large section for example is used as a toy center for Christmas selling and as a lawn and garden center for spring. The store features large departments for do-it-yourself enthusiasts, and such departments have been expanded.

Rink's also has completed arrangements for construction of a 98,000 square foot store at Fairfield, Ohio, to replace a small unit nearby, and is actively seeking other locations. Opening of a 145,000 square foot addition to its distribution center added to fiscal 1972 expenses, but the center is improving the division's efficiency and its ability to maintain a rapid rate of expanson.

Now operating 14 stores compared with nine in April, 1971, Rink's has had to absorb many expenses inherent in an expansion of this size and in the opening of

New drug store opened in shopping center at Huron, Ohio.

new distribution facilities. However, its potential has been broadened to an equal extent.

Bargain City Sales Up

Bargain City, with a strong reputation in hard goods, enjoyed a 17 per cent increase in sales to $36,791,000 during the past year.

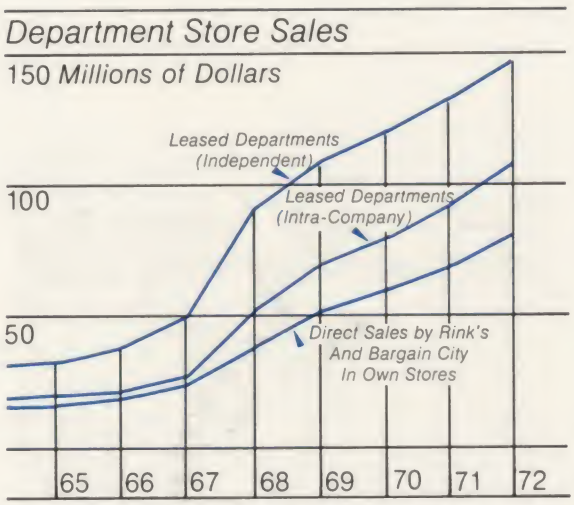
Most of Bargain City's sales increase came in stores open for both of the past fiscal years. The acquired Ann Arbor store was not opened until November and the new 100,000 square foot store at Bellefontaine, Ohio opened in March.

The turn-around of the Ann Arbor store to profitable operation shortly after its acquisition was a repeat of a success achieved in fiscal 1971 when the same results were obtained at another acquired store which had not been successful under other management.

In addition to the new 100,000 square foot store under construction at Sidney, Ohio, other new locations are under negotiation.

Bargain City's stores have traditionally featured hard goods lines, and it has been emphasizing expansion of lumber and home improvement departments with good results.

Drug Division and Rink's departments in Bargain City stores increased sales during the year. Other leased departments in its stores include shoes, fabrics, and pet



Fiscal 1972 and 1971 ended April 30; all other years ended June 30.

New Rink's store at Kettering, Ohio.

supplies. Supermarkets are adjacent to most of its stores, helping to draw consumer traffic.

Since moving into a new distribution and headquarters facility two years ago, Bargain City has improved the efficiency of operations and has also strengthened its management in preparation for continuing expansion.

Other Financial Information

Current assets of $69,057,611 at the fiscal year-end were in a 1.9 ratio to current liabilities, providing working capital of $33,241,218, compared with $21,398,868 a year ago. Net worth was $32,714,560 or $19.66 a share, and total assets were $86,530,953.

Dividends were at a quarterly rate of 30 cents a share or $1.20 for the year. We have paid a cash dividend during every year since 1929, our first year in business.

Organization and Methods

Gray Drug has made a major effort during recent years to develop an effective management team capable of guiding and improving our expanded operations, and this has included promotions both for senior executives and young managers.

Reflecting the growing importance of our department store divisions, Herbert S. Ives, responsible for the operation of Rink's, and Hyman R. Swolsky, founder and chief operating officer of Bargain City, were elected senior vice presidents of the corporation last year. Both had been vice presidents.

Scenes in new Bargain City store at Bellefontaine, Ohio. Lower photo shows Drug Division's leased department in this store.

The Company is continuing its program for development of management control information through data processing. Recent completion of a Model 145 IBM System 370 represents the fifth updating of computer equipment since our first installation 15 years ago, and we believe that our EDP programs are among the most advanced in our industry.

The increased power of the new central processor, together with additions to the peripheral input-output units, provides a centralized data center to meet the needs of

Rink's and Bargain City as well as the Drug Division.

The proven inventory management system which has effectively controlled the Cleveland and Fort Lauderdale distribution centers of the Drug Division is being extended to the Rink's distribution center at Cincinnati and the Bargain City distribution center at Toledo. The smaller computer presently in use at Rink's will be withdrawn and all data processing centralized at our Cleveland data center with telecommunication links to Cincinnati, Toledo and Fort Lauderdale.

A number of specialized computer programs have been developed as a contribution to operating efficiency at the automated Drug Division distribution center in Cleveland.

Plans are well along for installation of Pitney Bowes-Alpex electronic point-of-sale register equipment in Rink's stores. Tests in several stores have proven satisfactory and completion in all Rink's units is expected by late 1972.

The Company currently is considering leasing and operating its own truck fleet as a means of effecting savings and improving efficiency in the movement of merchandise from our warehouses to our stores.

Summing Up

Gray Drug incurred large expenses during the past year . . . in opening new stores, in promotion programs for acquired stores, in a shift to discount pricing at our drug stores, in the start-up of new or expanded distribution centers, in strengthening management, and in improvement of our computer operations.

In spite of these expenses, and the problems of inflation, new taxes, and a less than booming consumer economy, we were able to grow rapidly and to improve profits . . . to an increasing extent as the year progressed.

We have a specific and proven method of operation involving development of regional strength to meet the challenges of the highly competitive retail fields we serve, and we believe that our organization, made up of 6000 men and women, has never been stronger than it is today.

Partial view of our expanded central computer center.

New Selling Areas Added

Drug Division

	City	Selling Area (Square Feet)
New Drug Stores Opened		
Huron Plaza	Huron, Ohio	5,118
Franklin Park Mall	Toledo, Ohio	6,634
North Canton Plaza	North Canton, Ohio	5,746
Leased Drug Departments Opened in Department Stores		
Clarkins, 12800 Brookpark Road	Cleveland, Ohio	5,110
Clarkins, 380 Rockside Road	Bedford, Ohio	5,040
Clarkins, 26100 Euclid Avenue	Euclid, Ohio	5,040
Clarkins, 1016 East Broad Street	Elyria, Ohio	6,610
Rink's, 5959 Bigger Road	Kettering, Ohio	4,627
Bargain City, 880 East Sandusky Road	Bellefontaine, Ohio	3,910
Bargain City, 2465 West Stadium Boulevard	Ann Arbor, Michigan	3,577
Drug Stores Purchased		
3330 North Roosevelt Boulevard	Key West, Florida	5,500
Outlets Closed or Sold		
12557 Biscayne Boulevard	North Miami, Florida	4,200
47 East Ocean Boulevard	Stuart, Florida	2,000
917 North Federal Highway	Ft. Lauderdale, Florida	2,510
Whitehall, 4661 East Main Street	Columbus, Ohio	4,200
King, 1260 West Fifth Avenue	Columbus, Ohio	2,472
14801 Detroit Avenue	Lakewood, Ohio	3,599
King, 27 Lincoln Way East	Massillon, Ohio	1,320
Woolco, 4900 Shelbyville Road	Louisville, Kentucky	2,645
Net Drug Division Gain — 3 Outlets	*Total*	*33,966*

Department Store Divisions

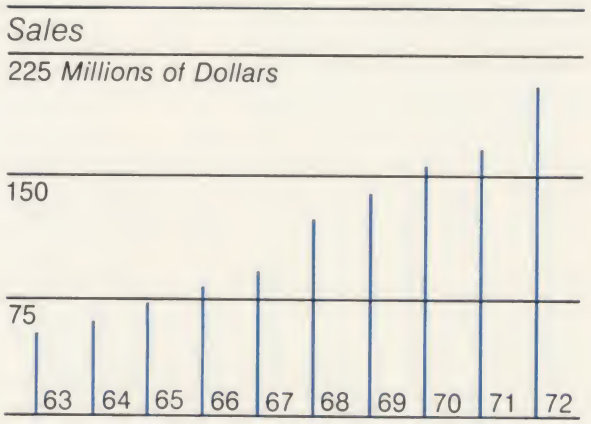
New Stores Opened		
Bargain City, 880 East Sandusky Avenue	Bellefontaine, Ohio	68,057
Bargain City, 2465 West Stadium Boulevard	Ann Arbor, Michigan	56,869
Rink's, 5959 Bigger Road	Kettering, Ohio	87,852
Total Department Store Gain — 3 new stores		*212,778*

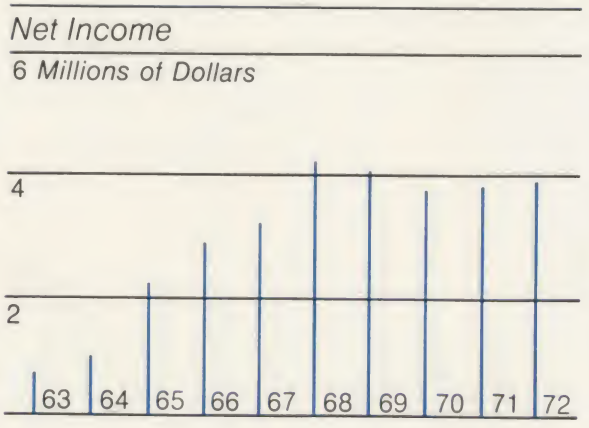
Grand Total, New Selling Area
Ten Months July 1, 1971 - April 30, 1972 ***246,744***

And 23 new Drug Division outlets are scheduled plus four large new department stores.

Ten Year Financial Summary

Fiscal Years Ended	April 30 (1)			
	1972	1971	1970	1969
Net Sales	$203,671,431	$167,218,553	$155,964,997	$140,752,138
Income Before Income Taxes	7,463,249	7,583,559	7,447,338	7,432,460
Net Income	3,906,249	3,814,559	3,747,338	4,040,460
Income Per Common Share (2)	2.35	2.29	2.25	2.43
Income as a Percentage of Sales	1.92%	2.28%	2.40%	2.87%
Income as a Percentage of Shareholders' Equity	11.94%	12.39%	12.84%	14.73%
Cash Dividends Declared — Common Stock	1,995,348	1,995,048	1,995,048	1,995,048
Dividends Per Share	1.20	1.20	1.20	1.20
Number of Shares Issued	1,663,790	1,662,540	1,662,540	1,662,540
Net Working Capital	33,241,218	21,398,868	22,986,096	23,074,329
Total Assets	86,530,953	69,852,334	60,339,545	52,751,685
Long-Term Debt	18,000,000	5,800,000	6,400,000	7,496,076
Shareholders' Equity	32,714,560	30,780,690	29,178,363	27,426,073
Book Value Per Share	19.66	18.51	17.55	16.50
Property and Equipment Additions — Net	3,976,697	3,719,610	1,565,531	1,956,545
Depreciation and Amortization	1,707,502	1,406,047	1,320,722	1,271,545
Units in Operation End of Year	270	265	214	203



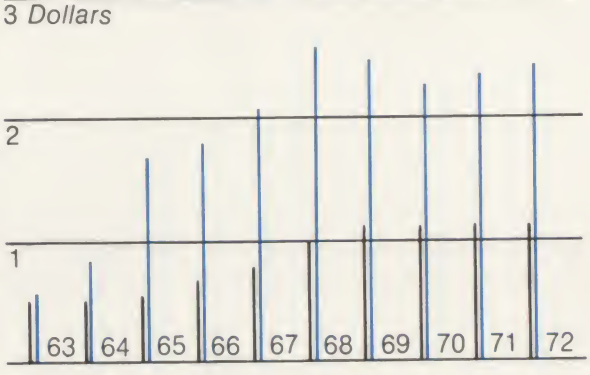


June 30					
1968	1967	1966	1965	1964	1963
$124,899,300	$93,598,735	$83,352,705	$73,570,697	$57,320,337	$51,875,334
7,698,566	6,087,794	5,581,032	4,337,653	2,011,104	1,399,066
4,193,766	3,256,894	2,912,432	2,176,053	946,404	662,366
2.52	2.01	1.79	1.72	.80	.56
3.36%	3.48%	3.49%	2.96%	1.65%	1.28%
16.52%	14.73%	14.53%	16.55%	8.78%	6.41%
1,662,540	1,202,550	858,805	568,641	503,723	503,723
1.00	.74	.59	.45	.43	.43
1,662,540	1,625,040	1,625,040	1,266,664	1,180,601	1,180,601
21,434,044	15,077,210	13,786,368	12,431,574	12,132,632	11,692,984
47,565,850	33,533,717	31,711,280	28,532,091	22,764,138	21,203,745
6,592,151	—	—	5,141,300	5,141,300	5,230,000
25,380,661	22,099,435	20,045,091	13,144,946	10,783,652	10,340,971
15.27	13.60	12.34	10.38	9.13	8.76
1,661,586	1,465,563	1,141,939	1,184,347	813,084	923,337
1,166,604	982,297	967,289	869,409	731,322	758,985
203	187	173	158	151	152

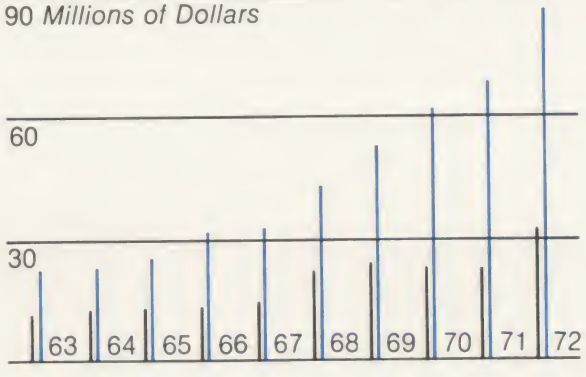
(1) Fiscal year end changed to April 30 effective with fiscal 1972. Fiscal 1971 figures recast to reflect change.

(2) Based upon the number of shares outstanding at the end of each year for the fiscal years ended 1963 through 1966 and based upon the average number of shares outstanding during the year for each of the fiscal years ended 1967 through 1972, adjusted to reflect a 3 for 2 stock split on September 30, 1966, and a 5 for 4 stock split on November 6, 1967.

Dividends/Earnings Per Share



Working Capital/Assets



Consolidated Balance Sheets

Gray Drug Stores, Inc. and Subsidiaries

	APRIL 30 1972	1971
ASSETS		
CURRENT ASSETS		
Cash	$ 2,952,193	$ 2,264,769
Accounts receivable, less allowance of $40,000	3,003,197	2,035,563
Inventories — priced generally on the basis of the lower of cost (latest) or replacement market	62,067,151	49,230,961
Prepaid expenses	1,035,070	1,139,219
TOTAL CURRENT ASSETS	69,057,611	54,670,512
OTHER ASSETS	423,351	476,482
PROPERTY AND EQUIPMENT — on the basis of cost		
Land (1972 — $457,099; 1971 — $452,599) and buildings	925,974	921,474
Furniture, fixtures and equipment	11,590,998	9,779,794
Leasehold improvements	6,177,518	4,891,707
	18,694,490	15,592,975
Less allowances for depreciation and amortization	6,731,600	5,899,280
	11,962,890	9,693,695
GOODWILL — Note C	5,087,101	5,011,645
	$86,530,953	$69,852,334
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable to banks	$11,000,000	$11,000,000
Trade accounts	17,848,955	14,388,346
Other liabilities and accrued expenses	4,201,641	3,718,848
Taxes other than income taxes	1,180,834	894,743
Income taxes	784,963	2,173,631
Current portion of long-term debt	800,000	1,096,076
TOTAL CURRENT LIABILITIES	35,816,393	33,271,644
LONG-TERM DEBT — less current portion — Note D		
Note payable to bank	5,000,000	5,800,000
Notes payable to insurance companies	13,000,000	-0-
	18,000,000	5,800,000
SHAREHOLDERS' EQUITY — Notes D and E		
Common Stock, par value $1 a share: Authorized — 3,000,000 shares; Outstanding, 1972 — 1,663,790 shares; 1971 — 1,662,540 shares	1,663,790	1,662,540
Capital in excess of par value	9,229,016	9,207,297
Retained earnings	21,821,754	19,910,853
	32,714,560	30,780,690
COMMITMENTS — Note F		
	$86,530,953	$69,852,334

See notes to financial statements.

Statements of Consolidated Changes in Financial Position

Gray Drug Stores, Inc. and Subsidiaries

	YEAR ENDED APRIL 30 1972	1971
SOURCE OF FUNDS		
From operations:		
Net income	$ 3,906,249	$ 3,814,559
Depreciation and amortization (principally straight-line method) which did not affect working capital	1,707,502	1,406,047
Total from operations	5,613,751	5,220,606
Long-term borrowings	13,000,000	-0-
Decrease in other assets	53,131	-0-
Sale of stock under option plan	22,969	-0-
	18,689,851	5,220,606
APPLICATION OF FUNDS		
Purchase of 30 conventional drug and discount department stores	-0-	7,260,349
Less inventories purchased	-0-	5,247,605
Property and equipment purchased	-0-	2,012,744
Expenditures for property and equipment, net of normal retirements	3,976,697	1,706,866
Current maturities of long-term debt	800,000	1,096,076
Goodwill purchased	75,456	554,537
Cash dividends declared	1,995,348	1,995,048
Increase in other assets	-0-	110,295
	6,847,501	7,475,566
INCREASE (DECREASE) IN WORKING CAPITAL	$11,842,350	$(2,254,960)
Summary of major changes in working capital:		
Asset increase (decrease):		
Cash	$ 687,424	$ (282,430)
Accounts receivable	967,634	625,598
Inventories	12,836,190	10,536,850
Prepaid expenses	(104,149)	331,317
Liability (increase) decrease:		
Notes payable to banks	-0-	(8,000,000)
Trade accounts	(3,460,609)	(4,477,570)
Other liabilities and accrued expenses	(482,793)	(458,447)
Taxes other than income taxes	(286,091)	(31,032)
Income taxes	1,388,668	(499,246)
Current portion of long-term debt	296,076	-0-
INCREASE (DECREASE) IN WORKING CAPITAL	$11,842,350	$(2,254,960)

See notes to financial statements.

Statements of Consolidated Income and Retained Earnings

Gray Drug Stores, Inc. and Subsidiaries

	YEAR ENDED APRIL 30 1972	1971
Net sales	$203,671,431	$167,218,553
Rent from leased departments	1,347,152	1,545,553
Other income	421,930	503,227
	205,440,513	169,267,333
Costs and expenses:		
Cost of goods sold	136,533,482	112,026,275
Selling, general and administrative expenses	58,188,710	47,297,205
Depreciation and amortization	1,707,502	1,406,047
Interest expense	1,547,570	954,247
	197,977,264	161,683,774
INCOME BEFORE INCOME TAXES	7,463,249	7,583,559
Income taxes — Note H	3,557,000	3,769,000
NET INCOME	3,906,249	3,814,559
Retained earnings at beginning of year	19,910,853	18,091,342
	23,817,102	21,905,901
Cash dividends declared	1,995,348	1,995,048
RETAINED EARNINGS AT END OF YEAR	$ 21,821,754	$ 19,910,853
Per share of Common Stock:		
Net income — based on the average number of Common Shares outstanding during each year	$2.35	$2.29
Cash dividends declared	1.20	1.20

Notes to Financial Statements

Gray Drug Stores, Inc. and Subsidiaries

Years ended April 30, 1972 and April 30, 1971

Note A — Change In Fiscal Year and Retroactive Adjustment

In fiscal 1972, the Company changed its fiscal year end from June 30th to April 30th. Accordingly, the consolidated financial statements of the Company and its subsidiaries for the fiscal year 1972 are presented for the year ended April 30, 1972 and, for comparative purposes, the consolidated financial statements for the fiscal year 1971 have been recast for the twelve months ended April 30, 1971. Therefore, the statement of consolidated income for the year ended April 30, 1971, includes net sales of approximately $26,800,000 and net income of approximately $716,000 ($.43 per share of Common Stock) for the period of two months ended June 30, 1970, previously reported in the operations for the fiscal year ended June 30, 1970.

In addition, the statement of consolidated income for the year ended April 30, 1971, has been adjusted to record a charge for the retroactive effect of the State of Ohio franchise-income tax enacted late in 1971. This provision ($302,000) reduced net income for that year by $160,000 ($.10 per share of Common Stock).

Note B — Principles of Consolidation and Acquisitions

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. Intercompany transactions and profits have been eliminated upon consolidation.

As of April 30, 1971, twenty-seven conventional drug stores and a warehouse were purchased from Cunningham Drug Stores, Incorporated at a cost of $4,504,000, and as of April 12, 1971, three discount department stores were purchased from Interstate Stores, Inc. at a cost of $2,756,000. Accordingly, the results of operations of these stores have been included in the accompanying financial statements since such dates.

Note C — Goodwill

Under the terms of a purchase agreement relating to the acquisition of certain companies, the Company made additional payments of the purchase price in the amount of 50% of the annual combined net income (as defined) of such companies through June 30, 1971, and added such amounts to goodwill.

Goodwill at April 30, 1972, represents the excess of cost of investment in purchased companies over their recorded net assets at acquisition dates (prior to 1969) and is not being amortized because, in the opinion of management, there has been no diminution in the values attributable thereto.

Note D — Long-Term Debt

The note payable to a bank is payable in quarterly installments of $200,000 each through March 31, 1975, and a final installment of $3,400,000 on June 30, 1975, and bears interest at the prime commercial rate (5% at April 30, 1972) plus ¼%.

During the fiscal year 1972, the Company sold to a group of insurance companies $13,000,000 principal amount of its 9% Notes due June 1, 1986. The proceeds were used to reduce short-term borrowings from banks in connection with the purchases described in Note B and to provide additional working capital. The notes are payable in annual installments of $1,300,000 beginning June 1, 1977.

The terms of the agreements include covenants covering maintenance of working capital and limiting payments of cash dividends and other capital distributions (as defined). Under the most restrictive of these covenants, retained earnings of approximately $5,421,000 were available at April 30, 1972 for distribution to shareholders.

The aggregate maturities of long-term debt for the next five years are:
1973 through 1975 — $800,000 annually; 1976 — $3,400,000; and 1977 — none.

Note E — Shareholders' Equity

Under the Company's stock option plan, options may be granted to officers and other key employees to purchase shares of Common Stock at not less than the market price of the shares at date of grant. Options granted become exercisable, cumulatively, to the extent of one-fourth annually beginning one year from date of grant and expire in a maximum of five years from date of grant. The following tabulation summarizes certain additional information regarding the Company's stock option plan.

		OPTION PRICE	
	SHARES	PER SHARE	AGGREGATE
Outstanding at May 1, 1970	29,750	$46.25	$1,375,938
Canceled	1,000	46.25	46,250
Granted*	18,500	18.375 and 23.75	350,687
Outstanding* at April 30, 1971	47,250	18.375 to 46.25	1,680,375
Canceled	1,000	46.25	46,250
Exercised	1,250	18.375	22,969
Outstanding* at April 30, 1972	45,000	18.375 to 46.25	1,611,156

*During 1971, the Company also granted options for 29,250 shares (of which options for 2,000 shares subsequently were canceled) at $18.375 a share, to certain optionees holding options for an equal number of shares at $46.25 a share. The lower-priced options are not exercisable until the previously granted higher-priced

options have expired, and to the extent the higher-priced options are exercised, the number of shares subject to the lower-priced options will be correspondingly reduced. Should all the lower-priced options be exercised, the proceeds to the Company would be $759,594 less than the aggregate option price at April 30, 1972.

At April 30, 1972 and 1971, options for 24,177 shares and 14,375 shares, respectively, were exercisable, and at April 30, 1972, 3,750 shares were reserved for future grants.

Proceeds of $22,969 from the exercise of stock options during the fiscal year 1972 were credited to Common Stock ($1,250) and capital in excess of par value ($21,719). There were no other changes in the Common Stock and capital in excess of par value accounts in either year.

Note F — Commitments

The Company and its subsidiaries are lessees under a number of leases extending over various periods up to thirty years. The annual minimum rental payable under such leases (most of which provide for additional rental if sales exceed minimum amounts) amounted to approximately $7,220,000 at April 30, 1972.

In addition to normal purchase commitments, the Company has entered into agreements to purchase (subject to certain conditions including, in some cases, cancellation options) up to approximately $2,300,000 of electronic point-of-sale register equipment.

Note G — Pension Plans

The Company and its subsidiaries have two noncontributory pension plans covering certain of their employees. Total pension expense was $371,000 for 1972 ($452,000 for 1971), including amortization of past service costs to the retirement age of participants. The Company's policy is to fund pension costs accrued.

Note H — Income Taxes

The investment tax credit, accounted for by the flow-through method, was $160,000 in 1972 (none in 1971).

Income taxes include a provision for state income taxes of $372,000 in 1972 ($377,000 in 1971).

Accountants' Report

Shareholders and Board of Directors
Gray Drug Stores, Inc.
Cleveland, Ohio

We have examined the consolidated balance sheets of Gray Drug Stores, Inc. and subsidiaries as of April 30, 1972 and April 30, 1971, and the related statements of consolidated income and retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying statements identified above present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at April 30, 1972 and April 30, 1971, and the consolidated results of their operations, changes in shareholders' equity and financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst + Ernst

Cleveland, Ohio
July 7, 1972

Board of Directors

Herbert H. Durr
Vice-President
Gray Drug Stores, Inc.

C. W. Evans
Chairman of the Board
Gray Drug Stores, Inc.

Marvin L. Kahn
Senior Vice-President,
Drug Division
Gray Drug Stores, Inc.

James D. McClimans*
Senior Vice-President,
Administration
Gray Drug Stores, Inc.

C. B. McDonald*
Limited Partner
McDonald & Company

John W. Reavis*
Managing Partner
Jones, Day, Cockley & Reavis

Irving I. Stone
President
American Greetings Corporation

Hyman R. Swolsky
Senior Vice-President,
Bargain City Division
Gray Drug Stores, Inc.

David M. Thoburn*
Senior Vice-President
The Cleveland Trust Company

Adolph Weinberger
Honorary Chairman of the Board
Gray Drug Stores, Inc.

Jerome A. Weinberger*
President and Chief Executive
Gray Drug Stores, Inc.

**Member of Executive Committee*

Transfer Agent

The Cleveland Trust Company
Cleveland, Ohio

Chemical Bank
New York, N. Y.

Registrar

The Central National Bank
Cleveland, Ohio

The Chase Manhattan Bank
New York, N. Y.

Corporate Officers

Adolph Weinberger
Honorary Chairman of the Board

C. W. Evans
Chairman of the Board

Jerome A. Weinberger
President and Chief Executive

Herbert S. Ives
Senior Vice-President,
Rink's Division

Marvin L. Kahn
Senior Vice-President,
Drug Division

James D. McClimans
Senior Vice-President,
Administration

Hyman R. Swolsky
Senior Vice-President,
Bargain City Division

Louis Berwitt
Vice-President and Secretary

Robert E. Breig
Vice-President

Herbert H. Durr
Vice-President

Edward P. Habegger
Vice-President

Kenneth Frey
Treasurer

Albert F. Hanzlick
Controller

William Whitlinger
Assistant Controller

Donald E. Collins
Assistant Secretary

Stock Listed

New York Stock Exchange
Midwest Stock Exchange

Auditors

Ernst & Ernst
Cleveland, Ohio

Counsel

Jones, Day, Cockley and
Reavis
Cleveland, Ohio

Main Office

666 Euclid Avenue
Cleveland, Ohio 44114

Divisional Operating Officers

Drug Division

Marvin L. Kahn
Senior Vice-President

Herbert H. Durr
Vice-President, Merchandising

Ezra Sacks
Vice-President, Operations

A. Joel Arnold
Vice-President, Drug Stores

Robert Bailey
Vice-President, Leased Drug Departments

Robert Kwait
Vice-President, Florida Stores

David Peterson
Vice-President, Purchasing

Bargain City Division

Hyman R. Swolsky
Senior Vice-President

Solomon Norflus
Vice-President, Southern District

Samuel Shible
Vice-President, Northern District

Albert M. Negrin
Treasurer

Rink's Division

Herbert S. Ives
Senior Vice-President

Fred Grant
Vice-President, Operations

Irvin Kahn
Vice-President, Merchandising

Joseph Tulman
Vice-President, Merchandising

Clifford P. Laemmle
Treasurer

Drug Division Warehouses

9450 Allen Drive
Cleveland, Ohio 44125

901 Northwest 31st Ave.
Fort Lauderdale, Florida 33311

Rink's Division Headquarters

201 W. Crescentville Road
Cincinnati, Ohio 45246

Bargain City Division Headquarters

3115 Frenchmens Road
Toledo, Ohio 43607

Gray Drug Stores, Inc., 666 Euclid Avenue, Cleveland, Ohio 44114